WORLD BANK OPERATIONS EVALUATION DEPARTMENT

OED REACH

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OED Review of The HIPC Initiative

Based on *The Heavily Indebted Poor Countries (HIPC) Debt Initiative: An OED Review*

- The Heavily Indebted Poor Countries (HIPC) debt initiative marks a major innovation in development finance. It has rendered the processes in the sovereign debt regime more open and accountable and spurred development cooperation, including enhanced collaboration between the Bank and the IMF.
- The fundamental goal of the initiative – to reduce the external debt of the HIPCs and provide them with a "fresh start" – is likely to be achieved, provided that the anticipated debt relief is delivered. The 26 countries that have passed their decision points are already benefiting from significantly lower debt service. But the initiative's objectives have expanded and become more ambitious – to provide a permanent exit from debt rescheduling, accelerated growth, and increased social spending.
- A big challenge now facing the initiative is to manage the expectations of what it can achieve given current funding levels and the policy and institutional constraints in the HIPCs. A key assumption in the design of the initiative is that past aid levels will be maintained so that HIPC debt relief is additional to other aid flows. But the initiative by itself cannot ensure this. Similarly, achieving the objectives of growth and debt sustainability requires actions by the donor countries and the debtor countries that are beyond the scope and means of the initiative, including steps to foster exports and broad based growth.

Background

Responding to growing public concern with excessive debt burdens of some of the poorest countries, the HIPC initiative was created by a confluence of factors, including the ascendancy of international civil society organizations, their growing influence on major creditors, and a change in the Bank's leadership. Established in 1996 to remove the debt overhang as a constraint to economic growth and poverty reduction in many of the poorest countries, the goals of the initiative have become more ambitious. The modifications introduced in 1999 brought an expanded set of objectives—to provide a "permanent" exit from debt rescheduling, to promote growth, and to create fiscal space for social expenditures aimed at poverty reduction.

Main Findings

Relevance. The core purpose of the initiative, to reduce the high debt levels of HIPCs, is highly relevant from both political economy and economic or aid effectiveness perspectives. This is attested to by the wide support for the HIPC initiative among creditors, debtor countries, and international civil society. In many HIPCs, the initiative has also increased national awareness of the debt problem and is spurring efforts to improve debt management.

Adequacy of resources. HIPCs as a group are receiving an increasing share of declining global aid resources; transfers to other poor but not highly indebted countries appear to be declining correspondingly. But in absolute terms, HIPCs are receiving less than they did in 1995. These trends reflect funding limitations in development finance that cannot be overcome through design improvements internal to the initiative as currently conceived. A clear acknowledgment of the limitations imposed by aid levels would facilitate the realignment of the initiative's basic objectives with the resources available.

Social Sector Spending. The initiative's emphasis on expenditures in the social services has served to appreciably increase health and education spending in national budgets, but more focus on growth-enhancing programs is warranted. The current emphasis on social spending presents two challenges. First, the initiative's performance criteria are more focused on expenditures than on outcomes, even when increased expenditures may encounter absorptive capacity constraints. Second, debtor countries consider the allocation of HIPC resources to be inflexible, potentially weakening domestic ownership of the initiative and hence the achievement of its objectives.

Policy Performance. A key requirement for qualification for HIPC relief is a track record of strong policy performance. The countries that have reached completion point have had strong policy track records, but the application of the policy performance requirement was progressively reduced in the enhanced HIPC, particularly for the countries that qualified in late 2000. Many of these countries have yet to demonstrate an ability to put such frameworks in place, raising concerns about the achievement of the HIPC objectives for these countries.

Realistic Forecasts. A key element in assessing the initiative's likelihood of achieving its core objective of debt sustainability is the projection of the debt indicators. The debt-inventory methodology for estimating the current levels of debt is a positive innovation. The methodological basis underlying the projections of future debt levels needs to be made explicit, and the economic forecasts made more realistic. In particular, they need to better capture the potential effects of volatility in export earnings.

Recommendations

The HIPCs' unmanageable debt is a symptom of deeper structural problems. While the HIPC initiative appears likely to provide much-needed respite from high debt service, debt relief is not a panacea for broader economic development problems, nor is a one-time debt reduction a guarantee that the problem will not re-emerge. Perhaps the greatest challenge facing the initiative is the expectations of what it can achieve within existing financing limitations.

Four actions are recommended:

- Clarify the purpose and objectives of the initiative, ensure that its design is consistent with these objectives, and that both the objectives and how they are to be achieved are clearly communicated to the global community.
- Improve the transparency of the economic models and methodology underlying the debt projections and the realism of economic growth forecasts in the debt sustainability analyses. This would facilitate decision making by providing a better assessment of the prospects and risks facing individual countries.
- Maintain the standards for policy performance. This would reduce the risks to achieving and maintaining the initiative's objectives. When the established policy performance criteria need to be relaxed, there should be a clear and transparent rationale.
- The performance criteria need to increase the focus on pro-poor growth. There should be a better balance between growth-enhancing and social expenditures, relative to the current emphasis on the latter.

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